

**DEPARTMENT OF STATE REVENUE  
LETTER OF FINDINGS NUMBER: 95-0630 ITC  
Gross Income Tax — Satellite Transmission Services  
For Tax Periods: 1991 through 1993**

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**ISSUES**

**I. Gross Income Tax — Satellite Transmission Services**

**Authority:** IC 6-22.1-1-2; IC 6-2.1-1-13; IC 6-2.1-3-3  
45 IAC 1-1-49; 45 IAC 1-1-140; 45 IAC 1-1-124  
*Indiana-Kentucky Electric Corporation v. Indiana Department of State Revenue*, 598 N.E.2d 647 (Ind. Tax 1992)  
*UACC Midwest, Inc., v. Indiana Department of State Revenue*, 667 N.E.2d 232 (Ind. Tax 1996)

Taxpayer protests the proposed assessment of Indiana gross income tax on receipts derived from the sale of satellite transmission services.

**II. Tax Administration — Penalty**

**Authority:** IC 6-8-10-2.1  
45 IAC 15-11-2; 45 IAC 2.2-3-20

Taxpayer protests the imposition of a ten-percent (10%) negligence penalty

**STATEMENT OF FACTS**

Taxpayer provides the satellite transmission of basic television and pay-per-view movie services for the hotel and lodging industry. Additionally, taxpayer provides satellite distribution support services for Indiana network affiliates of a national broadcasting network. Under this agreement,

taxpayer transmits national television programming, via satellite, to the national broadcasting network's Indiana affiliates. At issue is Audit's inclusion of the receipts from sales of both types of satellite transmission services in taxpayer's Indiana gross income.

# **I. Gross Income Tax — Satellite Transmission Services**

## **DISCUSSION**

Taxpayer transmits from out-of-state, via satellite, certain programs to various Indiana locations. Satellite receivers are placed at each customer's location – i.e., at the hotels, motels, and at the national television network's local affiliates. Taxpayer owns these satellite receivers. Additionally, at the hotels and motels, taxpayer owns the cables that lead from the receivers to the individual rooms, as well as the selection boxes provided with each television.

From these facts, and pursuant to 45 IAC 1-1-49, Audit found that taxpayer had sufficient contacts with Indiana (i.e., business situs) to justify inclusion of these receipts in taxpayer's Indiana gross income.

As 45 IAC 1-1-49 provides, in part:

For purposes of these regulations [45 IAC 1-1], a taxpayer may establish a "business situs" in ways including, but not limited to, the following:

\* \* \* \*

(2) Performance of services;

\* \* \* \*

(6) Ownership, leasing, rental or other operation of income-producing property (real or personal);

Since taxpayer derives income from services that are performed in Indiana, and taxpayer owns income-producing property within the State – e.g., the satellite receivers, related cables, and selection boxes – Audit concluded that taxpayer had sufficient contacts with the State to warrant inclusion of this income in taxpayer's Indiana gross income.

## **Transmission of network programming to local affiliates – statutory argument**

As an initial matter, taxpayer contends that gross income received from satellite distribution of national programming to local affiliates is exempt from Indiana gross income tax.

Specifically, taxpayer cites IC 6-2.1-3-28, which instructs:

Gross receipts derived directly from a national broadcasting network for broadcasting national network programs are exempt from gross income tax.

Taxpayer believes this language is directly on point regarding its Indiana activities.

### **Indiana destination transmissions – constitutional argument**

Next, taxpayer offers a constitutional argument in support of exemption. Notwithstanding the presence of income-producing property in the State, taxpayer argues that a "substantial portion of its business-generating activities occurred outside Indiana."

Taxpayer directs the Department's attention to IC 6-2.1-3-3, which states:

Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution

The crux of taxpayer's constitutional argument is that "Indiana cannot tax 100% of the receipts associated with the transmission of communications across state lines." Taxpayer observes that although Indiana may apportion such income, Indiana has chosen not to do so. Taxpayer introduces one statute (IC 6-2.1-3-28), and one regulation (45 IAC 1-1-124), as evidence of the Legislature's, and the Department's, endorsement of this "principle."

As illustration, 45 IAC 1-1-124(b) states:

Income from wire communications, including telephone and telegraph lines, is taxable if derived from carrying communications between two (2) points in Indiana. It is not taxable if derived from carrying communications between a point outside Indiana and a point in Indiana, or from a point outside Indiana into and across the State to a point outside Indiana.

Taxpayer believes the same principle should apply to the satellite transmission of television programming.

### **Department's response**

In response to taxpayer's initial argument, the Department finds taxpayer's receipts from satellite transmissions of national network programming, while derived from a "national broadcasting network", are not for "broadcasting national network programs." Taxpayer is in the business of

*transmitting* national programming, via satellite, from the national network to local affiliates. *Such transmission is not broadcasting.* It is the local affiliates who are engaged in broadcasting, not taxpayer.

Pursuant to IC 6-2.1-2-2(a)(2), nonresidents are subject to tax on gross income derived from Indiana sources.

(a) An income tax, known as the gross income tax, is imposed upon the receipt of:

(2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana.

In determining the taxability of non-residents, the court in *Indiana-Kentucky Electric Corp. v. Indiana Department of State Revenue (IKEC-OVEC)*, 598 N.E.2d 647 (Ind. Tax 1992), acknowledged the following test:

A three-step analysis is required to determine the taxability of a non-resident: (1) are the receipts gross income, (2) is the gross income derived from sources within Indiana, and (3) is the gross income that is derived from sources within Indiana 'taxable gross income? (Internal cites and quotations omitted.)

*Id.* at 661.

### **(1) Gross Income?**

As an initial matter, we must determine whether income received from satellite transmission services represents Indiana gross income. Both taxpayer and Audit agree these receipts meet the statutory definition of gross income as defined by IC 6-2.1-1-2.

### **(2) Income Derived From Indiana Sources?**

Next we must determine the source of taxpayer's gross income, as nonresidents are taxed only on income derived from Indiana sources. As 45 IAC 1-1-120 instructs, in part:

As a general rule, income derived from sales made by nonresident sellers to Indiana buyers is not subject to gross income tax unless the seller was engaged in business activity within the State [i.e., business situs] and such activity was connected with or facilitated the sales [i.e., tax situs].

In other words, not every business situs represents a tax situs. The court in *IKEC-OVEC* explained this relationship: "[T]he regulations teach that a nonresident is subject to taxation if the 'source' of the gross income is an Indiana *tax situs*, i.e., an Indiana *business situs* at which business activities are performed that are connected with or facilitate the transactions (sales) giving rise to the gross income. *Id.* at 662. (Emphasis added; internal quotes omitted.)

As Audit discovered, taxpayer does have an Indiana business situs – as represented by the locale of its income-producing property within the State (i.e., at the hotels, motels, and local network affiliates). Additionally, taxpayer performs services in Indiana. Either alone, or together, such presence is sufficient to establish an Indiana business situs. (See 45 IAC 1-1-49(2) and (6).)

To determine tax situs, however, we need to find whether the transactions giving rise to taxpayer's gross income are related to taxpayer's Indiana activities. And if so, are these related Indiana activities "more than minimal, and not remote or incidental to the total transaction." *Id.* at 663.

For purposes of this assessment, taxpayer is involved in two types of transactions: (1) taxpayer contracts with a national broadcast network to transmit programming to local affiliates for subsequent broadcast; and (2) taxpayer contracts with hotels and motels to transmit basic and pay-per-view programming. The hotels and motels then make this programming available to its guests.

It is clear from the description of the aforementioned transactions that taxpayer's gross income is related to its Indiana activities. And as the income is derived directly from these Indiana activities, the activities rise to a level that is neither minimal nor incidental to the relevant transactions.

### **(3) Indiana Taxable Gross Income?**

Finally, we ask whether this income represents "taxable gross income" as defined by IC 6-2.1-1-13.

"Taxable gross income" means the remainder of: (1) all gross income which is not exempt from tax under IC 6-2.1-3; less (2) all deductions which are allowed under IC 6-2.1-4.

As a prerequisite to any such finding, we must determine whether taxpayer's activities are exempt under the interstate commerce exemption. Pursuant to IC 6-2.1-3-3:

Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income

tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution.

For a state income tax to be constitutionally permissible, the tax must be fairly apportioned. The United States Supreme Court, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), announced a four-part test to determine whether a state tax violates the Commerce Clause of the United States Constitution. Our Indiana Tax Court later referenced this test in *Indiana-Kentucky Electric Corporation v. Indiana Department of State Revenue*, 598 N.E.2d 647, 656 (Ind. Tax 1992):

A state tax will survive a Commerce Clause challenge if the tax (1) is imposed on an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce in favor of local commerce, and (4) is fairly related to services the state provides.

Taxpayer argues that this tax, as assessed, is not fairly apportioned "because it attempts to tax 100% of [taxpayer's] receipts from its Indiana hotel customers."

It is the Department's position that income received from the transmission of pay-per-view and basic programming services to hotels and motels located in Indiana, as well as from the transmission of national television programming to local affiliates, is derived from the provision of a local service. This income is similar to that received from the provision of cable television service to Indiana customers, regardless of origin. See 45 IAC 1-1-124(c) and *UACC Midwest, Inc., v. Indiana Department of State Revenue*, 667 N.E.2d 232 (Ind. Tax 1996).

Consequently:

[W]hen a tax on gross receipts reaches only that part of the commerce which is carried on within the taxing state, whether it be intrastate or interstate, it is constitutionally valid and does not violate the Commerce Clause

*UACC* at 241 quoting *Cerracche Television Corp. v. Kelly*, 50 A.D.2d 134, 137 (N.Y.A.D. 1975).

### **FINDING**

Taxpayer's protest is denied.

## **II. Tax Administration — Penalty**

### **DISCUSSION**

The taxpayer protests the imposition of the ten-percent (10%) penalty. The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(e).

While taxpayer has not prevailed on its protest, taxpayer's positions were reasonable as they were based on bona fide interpretations of Indiana statutory, regulatory, and case authorities. Imposition of the negligence penalty, in this instance, would be inappropriate.

### **FINDING**

The taxpayer's protest is sustained.